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No. 91-913

In The

Supreme Court of the United States

October Term, 1991

JOHN R. PATTERSON, Trustee,

Petitioner,

vs.

JOSEPH B. SHUMATE, JR.,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Fourth Circuit

MOTION OF HALLMARK CARDS, INCORPORATED FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND ACCOMPANYING BRIEF OF AMICUS CURIAE IN SUPPORT OF RESPONDENT

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MOTION FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE

Hallmark Cards, Incorporated ("Hallmark") respectfully moves this Court for leave to file the accompanying brief in this case as *amicus curiae*. The consent of the attorney for Respondent has been obtained, but the attorney for Petitioner has refused to consent to the filing of a brief by Hallmark as *amicus curiae*.

Hallmark has an interest in this case because it is involved in several lawsuits with the same issues as those presented in this case. Hallmark is the administrator of several pension plans for 21,000 employees, some of whom reside in each federal circuit. To date, Hallmark has refused to turn over employees' pension plan interests to trustees in bankruptcy, because to do so would

violate the terms of its pension plans and could lead to disqualification of its pension plans by the Internal Revenue Service. One Bankruptcy Judge in the Western District of Missouri has ordered Hallmark to turn over an employee's interests in the Hallmark plans; that case is currently on appeal.

The positions of the parties herein will not adequately address Hallmark's interests because the facts in the case at bar center on an executive with some measure of control over the administration of the pension plan at issue. Petitioner has stated that the issue before the Court is "whether a debtor in bankruptcy, with control over and the power to revoke a pension plan, can exclude or exempt his interest in such a plan from his bankruptcy estate". Brief for Petitioner at 13. However, resolution of this case will have an impact on many pension plans throughout the nation that are not controlled by employees filing for bankruptcy. For example, none of the Hallmark employees who have filed for bankruptcy have had any involvement in the administration of Hallmark's pension plans. Nevertheless, this Court's decision on the inter-relationship of the Bankruptcy Code and the Employee Retirement Income Security Act ("ERISA") may impact all employees of Hallmark. If Petitioner's position is accepted, the pension benefits of all Hallmark employees are jeopardized.

Although Hallmark supports the position of Respondent in this case, Respondent's arguments do not adequately address the situation of a large employer – such as Hallmark – that is faced with the dilemma of protecting the pension benefits of thousands of employees while

complying with court orders that might cause disqualification of the pension plans and disastrous tax consequences for all participants.

Moreover, Hallmark faces differing results in different federal circuits if the Petitioner's arguments are accepted. There is a sharp split among the United States Courts of Appeals that have considered this issue – the courts in five judicial circuits have ruled that the pension benefits must be turned over to a trustee in bankruptcy for distribution to his creditors, while the courts in four circuits have reached the opposite conclusion.

For these reasons, Hallmark believes that the Court should consider the perspective of national employers when resolving this case. Neither of the parties herein brings that perspective to the Court.

Respectfully submitted,

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BRIEF OF AMICUS CURIAE HALLMARK CARDS, INCORPORATED IN SUPPORT OF RESPONDENT

STATEMENT OF HALLMARK'S INTEREST IN THE CASE

This case will determine whether the creditors of a bankrupt employee should have access to the employee's accrued pension benefits. It is clear that the same creditors could not reach the pension benefits outside of bankruptcy.

Hallmark Cards, Incorporated ("Hallmark") is the world's largest manufacturer of greeting cards and related personal communications products. The company has established one of the best employee benefit packages

in the United States.[1] The cornerstone of this benefit package is Hallmark's Employee Profit Sharing and Ownership Plan, a qualified pension benefit plan with assets in excess of $1.3 billion. The benefit package also includes three other qualified pension benefit plans with assets exceeding $500 million. More than 21,000 employees throughout the United States are eligible to participate in one or more of Hallmark's pension plans.

The issue in this case – whether an employee's interest in a pension plan is an asset of his estate in bankruptcy – is significant to Hallmark because the fundamental purpose of its pension plans is to provide for Hallmark employees and their families in retirement. Hallmark has a legitimate interest in seeing that benefits accrued under its pension plans are preserved for their intended purposes.

Equally important to Hallmark are the potential consequences of paying benefits to a trustee in bankruptcy in violation of the anti-alienation provisions in its pension plans. ERISA requires that a qualified pension benefit

[1] For example, when Hallmark's Career Reward Program was created in 1956, it was hailed as "the country's most liberal employee-benefit and profit-sharing plan." Freedgood, *Joyce Hall is Thinking of You*, 58 FORTUNE 94 (December 1958). More recently, the benefit program was identified as the primary reason Hallmark was selected as one of the nation's top employers in R. LEVERING, M. MOSKOWITZ & M. KATZ, THE 100 BEST COMPANIES TO WORK FOR IN AMERICA 131-32 (1984) (Hallmark ranked in top ten companies), and by WORKING MOTHER in each of the years 1986 through 1991. *See* Moskowitz and Townsend, *The 85 Best Companies for Working Mothers*, 14 WORKING MOTHER, No. 10 (October 1991).

plan be administered in accordance with the plan document; failure to do so is a breach of Hallmark's fiduciary duty which could result in liability. 29 U.S.C. §§ 1104(a)(1)(D) and 1109. Failure to administer the plan in accordance with its terms could also result in loss of the tax-exempt status for the plan and trust. If a pension plan is disqualified as tax-exempt, all accrued benefits would be immediately taxable to participants which would effectively destroy the plan. *See infra*, pp. 26-29.

For these reasons, Hallmark has vigorously contested all attempts to require turnover of employee benefits from its qualified pension plans. Thus, Hallmark – like many other national employers – has become ensnared in repeated bankruptcy disputes where the pension plan interest of the employee is the debtor's largest asset. It is important that this Court consider the impact of its decision in this case on millions of employees who participate in pension plans established by their employers and who – unlike Respondent – have no control over the administration of their pension plans.

SUMMARY OF ARGUMENT

Whether a debtor's interest in a pension plan should be available to creditors in bankruptcy depends on the inter-relationship of two federal statutes – the Employee Retirement Income Security Act of 1974 ("ERISA") and the Bankruptcy Code.[2] Early decisions by several United

[2] ERISA included four titles. Titles I, III, and IV are codified in 29 U.S.C. §§ 1001-1461. Title II of ERISA amended

(Continued on following page)

States Courts of Appeals found a "conflict" between ERISA and the Bankruptcy Code. These cases involved debtors with large interests in pension plans which they established and controlled and in which they were often the sole participants. The courts in those cases ignored the plain language of the Bankruptcy Code which excludes or exempts ERISA pension plan interests from the bankruptcy estate. Instead, these courts focused on ambiguous legislative history to justify the desired result.

The "conflict" between ERISA and the Bankruptcy Code is non-existent if the plain language of both statutes is read to exclude pension benefits from the bankruptcy estate. Excluding pension assets will also give full effect to ERISA's dual purposes of protecting retirement income and creating a uniform pension law throughout the nation.

ARGUMENT: REASONS FOR RULING FOR RESPONDENT

I. ERISA AND THE BANKRUPTCY CODE ARE NOT IN CONFLICT.

This Court has warned that "courts are not at liberty to pick and choose among congressional enactments, and

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many different sections of the Internal Revenue Code (IRC) to properly coordinate the tax provisions governing pension plans with the new Labor statute. References in this brief to ERISA will be to the original sections of that Act, as amended, and references to the IRC shall mean the Internal Revenue Code of 1986, as amended. References to the "Bankruptcy Code" shall mean the Bankruptcy Reform Act of 1978, as amended, 11 U.S.C. §§ 101-1330.

when two statutes are capable of co-existence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective." *Morton v. Mancari*, 417 U.S. 535, 551 (1974).

Although Bankruptcy Code § 541(a), 11 U.S.C. § 541(a), broadly defines the bankruptcy estate to include "all legal or equitable interests of the debtor in property as of the commencement of the case," Bankruptcy Code § 541(c)(2) provides that "a restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title." 11 U.S.C. § 541(c)(2). In other words, a debtor's interest in a trust is not included in his bankruptcy estate if the trust interest is subject to an enforceable restriction on transfer. In addition, property that is included in a debtor's bankruptcy estate may also be exempted from liquidation and distribution among his creditors by Section 522. Bankruptcy Code § 522(b)(2)(A) exempts from distribution "any property that is exempt under Federal law other than subsection (d) of this section", as well as property exempt under state law of the debtor's domicile. 11 U.S.C. §§ 522(b)(2)(A) and 522(d). Thus, a debtor's interest in a trust is not available to his creditors in bankruptcy if either (1) the interest is subject to an enforceable restriction on transfer so that the trust interest never enters the bankruptcy estate, or (2) the trust interest is included in the estate but exempted from distribution by federal law other than Bankruptcy Code § 522(d).

ERISA § 206(d)(1) requires that "Each pension plan shall provide that benefits provided under the plan may not be assigned or alienated." 29 U.S.C. § 1056(d)(1).

ERISA § 403 generally requires all assets of a pension benefit plan to be held in trust. 29 U.S.C. § 1103. IRC § 401(a)(13)(A) states that a pension trust will not qualify as a tax-exempt entity under IRC § 501 "unless the plan of which such trust is a part provides that benefits provided under the plan may not be assigned or alienated." 26 U.S.C. §§ 401(a)(13)(A) and 501.

Therefore, the issue in this case should be resolved in favor of Respondent because the anti-alienation provisions required by ERISA and the IRC are enforceable restrictions under "applicable nonbankruptcy law" so that a debtor's interest in the pension plan never becomes part of the bankruptcy estate. Moreover, even if the interest is included in the estate, ERISA and the IRC provide an exemption of the interest in the pension plan and trust "under Federal law other than" Bankruptcy Code § 522(d).

ERISA and the Bankruptcy Code can be reconciled quite easily by simply reading and giving effect to the plain and unambiguous language of both statutes. "Unless exceptional circumstances dictate otherwise, '[w]hen we find the terms of a statute unambiguous, judicial inquiry is complete.'" *Anderson v. Raine (In re Moore)*, 907 F.2d 1476, 1479 (4th Cir. 1990) (quoting from *Burlington Northern R.R. v. Oklahoma Tax Comm'n*, 481 U.S. 454, 461 (1987)). This Court should resolve the split among the Courts of Appeals by directing lower courts to return to this fundamental principle of statutory construction.

A. The Plain Meaning of the Phrase "Applicable Nonbankruptcy Law" in Bankruptcy Code § 541(c)(2) Includes ERISA.

1. Early Cases Were Based on Equitable Considerations and Improperly Relied on Legislative History.

Bankruptcy Code § 541(c)(2) on its face excludes a debtor's interest in an ERISA pension trust from his bankruptcy estate: ERISA is "applicable" to pension plan trusts, it is "nonbankruptcy law", and the transfer restrictions which it requires to be included in pension plans have, except in bankruptcy, been uniformly held to be enforceable. *See, e.g., Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 493 U.S. 365 (1990).

Unfortunately, the first cases on this issue to reach the courts of appeals involved self-employed professionals who established and controlled their own pension plans. These courts held that the words "applicable nonbankruptcy law" do not mean what they say; they found that what Congress *really* meant to exclude from the bankruptcy estate was only an interest in a trust which qualifies as a traditional spendthrift trust under state law. *See Goff v. Taylor (Matter of Goff)*, 706 F.2d 574 (5th Cir. 1983); *Samore v. Graham (In re Graham)*, 726 F.2d 1268 (8th Cir. 1984); *Lichstrahl v. Bankers Trust (In re Lichstrahl)*, 750 F.2d 1488 (11th Cir. 1985); *Daniel v. Security Pacific Nat'l Bank (In re Daniel)*, 771 F.2d 1352 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986).[3] *Accord Regan v. Ross*, 691

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[3] The United States Courts of Appeals for the Fifth Circuit in *Goff* and the Eighth Circuit in *Graham* set out the arguments

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F.2d 81 (2d Cir. 1982) (involving state employee retirement system not subject to ERISA).

To prevent the professional and self-employed debtors from shielding large amounts in their pension plans, the courts in *Goff*, *Graham* and other early decisions ignored the plain statutory language. Instead, these courts considered the ambiguous legislative history of Section 541(c)(2) and concluded that Section 541(c)(2) referred solely to traditional spendthrift trusts. The courts further concluded that since these debtors established and controlled the trusts, the trusts were not traditional spendthrift trusts.

Petitioner's arguments follow the erroneous reliance of the *Goff* and *Graham* Courts on legislative history rather than on the statutory language. Brief for Petitioner at 38-39. This Court has repeatedly said that legislative history is to be considered only if the statutory language is unclear or ambiguous. *See Toibb v. Radloff*, ___ U.S. ___, 111 S.Ct. 2197, 2200 (1991); *Davis v. Michigan Department*

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in support of their position that Section 541(c)(2) should be limited to state spendthrift trust law. None of the later opinions added to the argument, so this brief will refer to *Goff* and *Graham* as representative of these cases.

Some earlier lower court cases did adopt a more literal reading of Bankruptcy Code §§ 541(c)(2) and 522(b)(2)(A). *See, e.g., In re Threewitt*, 24 Bankr. 927 (D. Kan. 1982); *In re Pruitt*, 30 Bankr. 330 (Bankr. D. Colo. 1983); *In re Mosley*, 42 Bankr. 181 (Bankr. D.N.J. 1984). These courts were not encumbered with the later result-oriented precedents established by appellate court decisions such as *Goff* and *Graham* and therefore applied the plain meaning to the statutory language.

of Treasury, 489 U.S. 803, 808 n.3 (1989); *Blum v. Stenson*, 465 U.S. 886, 896 (1984); *United Air Lines, Inc. v. McMann*, 434 U.S. 192, 199 (1977). Thus, there was no need for the Courts in *Goff* and *Graham* to look beyond the plain meaning of the statute.

Even if considered, the legislative history of the Bankruptcy Code on this subject is inconclusive. The Courts in both *Goff* and *Graham* cited House and Senate reports to support their conclusion that Section 541(c)(2) does not include ERISA as "applicable nonbankruptcy law". *Goff*, 706 F.2d at 581-82; *Graham*, 726 F.2d at 1271-72. However, these congressional reports state only that the Bankruptcy Code "continues over" or "preserves" the treatment afforded spendthrift trusts under the old Bankruptcy Act. The reports contain nothing delimiting the phrase "applicable nonbankruptcy law"; they simply indicate that state spendthrift trust laws are included within the phrase "applicable nonbankruptcy law".

While there might have been equitable reasons to include the pension assets of the debtors in *Goff* and *Graham* in their bankruptcy estates, the statutory interpretation was nevertheless faulty. The erroneous use of legislative history created a statutory interpretation which has now been extended to plans – such as Hallmark's – in which there are thousands of participants who have no involvement in the administration of the pension plans.[4]

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[4] The result-oriented nature of the early decisions was noted by the Bankruptcy Court for the Western District of

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2. More Recent Cases Have Correctly Relied on the Plain Meaning of the Phrase "Applicable Nonbankruptcy Law."

Recently, several courts of appeals have correctly concluded that Bankruptcy Code § 541(c)(2) *does* mean what it says. *See Anderson v. Raine (In re Moore)*, 907 F.2d 1476 (4th Cir. 1990); *Forbes v. Lucas (In re Lucas)*, 924 F.2d 597 (6th Cir. 1991); *Velis v. Kardanis*, 949 F.2d 78 (3d Cir. 1991); *Gladwell v. Harline (In re Harline)*, 950 F.2d 669 (10th Cir. 1991). In *Moore*, the Court of Appeals for the Fourth Circuit ruled that

> "Applicable nonbankruptcy law" means precisely what it says: all laws, state and federal, under which a transfer restriction is enforceable. Nothing in the phrase "applicable nonbankruptcy law" or in the remainder of

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Oklahoma in *In re Burns*, 108 Bankr. 308, 314 (Bankr. W.D. Okla. 1989). Petitioner appeals to the same equitable considerations by emphasizing the control that Respondent had over the pension plan at issue in this case. Brief for Petitioner at 55-58. However, the Court's decision in this case will impact many employees who have no real control over their pension plans. In fact, when applying spendthrift trust law to pension plans, courts in the Western District of Missouri have found that simply because an employee could quit his job and obtain the money in his pension plan account he had too much "control" for the plan to qualify as a spendthrift trust. Thus, even where the contributions were made by the employer, if the employee can quit and receive a payout, these courts have ordered turn over of the pension plan assets to the Bankruptcy Trustee. *Wachovia Bank and Trust v. Wear (In re Green)*, 123 Bankr. 327 (Bankr. W.D. Mo. 1990); *In re Farrell*, Case No. 90-40864 (Bankr. W.D. Mo. Feb. 19, 1991) (involving Hallmark's pension plans).

> § 541(c)(2) suggests that the phrase refers exclusively to state law, much less to state spendthrift trust law.

907 F.2d at 1477. These courts did not find it necessary to look beyond the statute to the legislative history. As the *Moore* Court concluded, "[t]he clarity of the statutory term is simply not clouded by the legislative history." 907 F.2d at 1479.

Moreover, as discussed in these recent cases, restricting the phrase "applicable nonbankruptcy law" to mean only state spendthrift trust law is inconsistent with other interpretations of the same phrase throughout the Bankruptcy Code, where the phrase has been held to refer to federal as well as state law.[5] *Moore*, 907 F.2d at 1477-78; *Velis*, 949 F.2d at 81; *Harline*, 950 F.2d at 674. As noted in *Moore*, when Congress intended to refer to "state law", it did so explicitly.[6] 907 F. 2d at 1477-78. In the case at bar, the Fourth Circuit stated that in *Moore*, it had

> looked to the plain language of the statute and found "applicable nonbankruptcy law" to be not

[5] For example, Bankruptcy Code § 1125(d) states that whether postpetition disclosure statements contain adequate information is "not governed by any otherwise applicable nonbankruptcy law" which has been held to include federal securities law. Bankruptcy Code § 108(a) extends the time in which a trustee can pursue a cause of action which the debtor could have pursued in accordance with the tolling provisions of "applicable nonbankruptcy law" which has been held to include the Racketeer Influenced and Corrupt Organization Act. *See Moore*, 907 F.2d at 1477-78.

[6] *See, e.g.*, Bankruptcy Code §§ 109(c)(2), 362(b)(12), 522(b)(1) and (2), 523(a)(5), 903, and 1145(a).

> limited to state law but also to embrace federal statutes, including ERISA. . . . [B]ecause ERISA enforces restrictions on the transfer of pension interests under its non-alienation requirement, it constitutes an "applicable nonbankruptcy law."

Shumate v. Patterson, 943 F.2d 362, 363-64 (4th Cir. 1991) (footnote omitted).

B. ERISA Is "Federal Law Other Than" Bankruptcy Under the Plain Meaning of Bankruptcy Code § 522(b)(2)(A).

If the plain meaning of Bankruptcy Code § 541(c)(2) excludes a debtor's interest in an ERISA pension plan from the bankruptcy estate, then no further inquiry is necessary. Nevertheless, there is an alternative provision in the Bankruptcy Code which would also prevent a bankruptcy trustee from obtaining a debtor's pension benefits.

Bankruptcy Code § 522(b) permits a debtor to exempt certain property from his bankruptcy estate in order to permit him a "fresh start." An individual debtor may choose to exempt either (1) property that is specified in subsection (d) of Section 522 (unless the debtor's domicile has "opted out" of the federal exemptions) or (2) property that is exempt under either "Federal law, other than subsection (d)" or the state law of the debtor's domicile. ERISA and the Bankruptcy Code can be reconciled and given full effect by recognizing that ERISA is "Federal law other than" Bankruptcy Code § 522(d) and

that ERISA's anti-alienation provisions exempt a participant's accrued benefits in a pension plan from any form of judicial process.[7]

Petitioner argues – and the Courts in *Goff* and *Graham* concluded – that ERISA does not create an exemption under "Federal law other than" the bankruptcy exemptions in Section 522(d). To reach this conclusion, Petitioner urges this Court to follow the reasoning in *Goff* and *Graham* and consider legislative history despite the unambiguous language of the statutes. In discussing Section 522(b)(2)(A), House and Senate reports listed "some of the items that may be exempted under Federal laws other than" the new Bankruptcy Code, H.R. Rep. No. 95-595, 95th Cong. 1st Sess. at 360, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6316. Although acknowledging that this list was not intended to be exhaustive, the Courts in *Goff* and *Graham* concluded that the omission of ERISA from the list was "probative" of congressional intent that ERISA was not one of the "Federal laws" under which an exemption could be claimed pursuant to Bankruptcy Code § 522(b)(2)(A). *Goff*, 706 F.2d at 585; *Graham*, 726 F.2d at 1274.

Discussing the interaction of ERISA and the Bankruptcy Code in another context, this Court stated that

> . . . the language of a statute . . . is not to be regarded as modified by examples set forth in

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[7] This argument was reserved by the Fourth Circuit in its opinion below, but was addressed by both parties in their briefs on the Petition for Certiorari and by Petitioner in his opening brief. *See* Brief for Petitioner at 49-55.

> the legislative history. An example, after all, is just that: an illustration of a statute's operation in practice. It is not, as the Court of Appeals apparently thought, a definitive interpretation of a statute's scope.

Pension Benefit Guaranty Corp. v. LTV Corp., 496 U.S. 633, 110 S. Ct. 2668, 2677 (1990). If Congress had intended to limit federal exemptions to those established by the statutes on the illustrative lists, it would have listed those statutes in the Bankruptcy Code.

Early appellate court decisions on this issue avoided giving Section 522(b)(2)(A) its plain meaning, and more recent appellate decisions have not found it necessary to address the question since the cases were resolved under Section 541(c)(2). However, several bankruptcy courts have recently held that ERISA does provide a federal exemption under Section 522(b)(2)(A). *In re Komet*, 104 Bankr. 799 (Bankr. W.D. Tex. 1989); *In re Burns*, 108 Bankr. 308 (Bankr. W.D. Okla. 1989); *In re Messing*, 114 Bankr. 541 (Bankr. E.D. Tenn. 1990); *In re Starkey*, 116 Bankr. 259 (Bankr. D. Colo. 1990). The Bankruptcy Court in *Komet* stated:

> [ERISA §] 206(d)(1) has been held by numerous federal courts to insulate retirement benefits from liability to state law levy or attachment, and thus functions as a privilege created by law sheltering certain property from creditor attachment – in short, an exemption created by federal law. Section 206(d) thus creates a federal exemption properly cognizable in bankruptcy, under the "other federal law" rubric of Section 522(b)(2)(A).

104 Bankr. at 808.

C. Bankruptcy Code § 522(d)(10)(E) Is Not Rendered Superfluous If "Applicable Nonbankruptcy Law" Includes ERISA.

As explained above, unless the state of his domicile has opted out of the federal exemptions, a debtor may elect to exempt property specified in Bankruptcy Code § 522(d). Section 522(d)(10)(E) generally exempts a

> debtor's right to receive . . . a payment under a stock bonus, pension, profit-sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor . . . .

11 U.S.C. § 522(d)(10)(E). Petitioner claims that this exemption will be rendered "superfluous" or "nugatory" if ERISA is found to be "applicable nonbankruptcy law" so that a debtor's interest in a pension plan is excluded from bankruptcy. Brief for Petitioner at 24-33.

This argument was rejected by the Third Circuit in *Velis*, which examined the different purposes of Sections 541 and 522:

> The argument that if "applicable nonbankruptcy law" in § 541(c)(2) includes both state and federal law, the exemption provisions of § 522(d)(10)(E) would be superfluous or meaningless overlooks the distinctions between the two sections. Section 522 deals with *distributions* made from a pension plan and distributions which the debtor has a present and immediate right to receive. Even if pension plan assets in the hands of a trustee are beyond the reach of creditors because not a part of the debtor's estate under § 541(c)(2), distributions

> made from the plan to the debtor would not enjoy such protection in the absence of exemption under § 522(d)(10)(E).

949 F.2d at 81-82 (emphasis in original; citation omitted). *See also Harline*, 950 F.2d at 675.

Petitioner claims that this view "attempts to create a distinction which does not exist." Brief for Petitioner at 32. However, there is a very real difference between an interest in a pension trust that cannot be paid under the terms of the trust until some future event, such as termination of employment or attainment of a specified retirement age, and the right to receive an immediate payment from the same pension plan and trust.

Furthermore, the exemption provided by Section 522(d)(10)(E) covers a plethora of pension plans, savings plans, bonus plans, and other employment benefits that are not subject to the anti-alienation provisions of ERISA. Excluding an interest in an ERISA plan and trust under Section 541(c)(2) does not make this exemption "superfluous" or "nugatory".

II. EXCLUDING OR EXEMPTING PENSION PLAN ASSETS FROM THE BANKRUPTCY ESTATE IS CONSISTENT WITH THE MOST RECENT SUPREME COURT DECISION ON ERISA'S ANTI-ALIENATION PROVISIONS.

This Court recently considered the anti-alienation provisions of ERISA § 206(d)(1) in *Guidry v. Sheet Metal Workers National Pension Fund*, 493 U.S. 365 (1990), and emphasized the absolute nature of ERISA's anti-alienation provisions. In *Guidry*, a union official had embezzled

money from the union, which sought to impose a constructive trust on benefits payable to the official from a union pension plan to satisfy a judgment obtained by the union. The district court imposed the constructive trust in favor of the union, relying on the Labor-Management Reporting and Disclosure Act of 1959 ("LMRDA"), 29 U.S.C. §§ 401-531, to find a "narrow exception" to ERISA's anti-alienation provisions where a union and its members were "damaged by the knavery of a union official". 493 U.S. at 370 (quoting district court opinion). The United States Court of Appeals for the Tenth Circuit affirmed, reasoning that ERISA's anti-alienation provision could not be invoked to protect a dishonest plan fiduciary whose breach of duty injured the beneficiaries of the plan.

However, this Court reversed, and would not countenance an end run on the express prohibition found in ERISA § 206(d)(1), "unless some exception to the general statutory ban is applicable." *Guidry*, 493 U.S. at 372. After concluding that LMRDA did not override the plain language of ERISA, this Court also made clear that the union official's wrongdoing did not justify an "equitable remedy":

> Nor do we think it appropriate to approve any generalized equitable exception – either for employee malfeasance or for criminal misconduct – to ERISA's prohibition on the assignment or alienation of pension benefits. . . .
>
> As a general matter, courts should be loath to announce equitable exceptions to legislative requirements or prohibitions that are unqualified by the statutory texts. The creation of such

> exceptions, in our view, would be especially problematic in the context of an anti-garnishment provision. Such a provision acts, by definition, to hinder the collection of a lawful debt. A restriction on garnishment therefore can be defended *only* on the view that the effectuation of certain broad social policies sometimes takes precedence over the desire to do equity between particular parties. It makes little sense to adopt such a policy and then to refuse enforcement whenever enforcement appears unequitable. A court attempting to carve out an exception that would not swallow the rule would be forced to determine whether application of the rule in particular circumstances would be "especially" inequitable. The impracticability of defining such a standard reinforces our conclusion that the identification of any exception should be left to Congress.

Id. at 376-77 (emphasis in original).[8]

Petitioner seeks to distinguish the facts of this case by arguing that *Guidry* was not a bankruptcy case. Brief for Petitioner at 19-20, 44-46. However, the facts of *Guidry* were even more compelling for the creditors than those in this case. In *Guidry*, the judgment creditor had been

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[8] The Court in *Guidry* reserved the question whether a breach of fiduciary duty *to the plan* rather than to the union would justify a constructive trust or other form of garnishment against the fiduciary's benefits from the plan. 493 U.S. at 373. However, the United States Court of Appeals for the Fifth Circuit, relying on *Guidry*, subsequently concluded that even a breach of fiduciary duty to the plan could not justify an exception to ERISA's absolute prohibition on alienation. *Herberger v. Shanbaum*, 897 F.2d 801, 803-04 (5th Cir. 1990).

injured by the debtor's *criminal misconduct*. The LMRDA did not create a "narrow exception" to ERISA's prohibition on alienation; neither does the Bankruptcy Code. If neither employee malfeasance nor criminal misconduct justifies an equitable exception to ERISA's prohibition on alienation of pension benefits, certainly a bankruptcy proceeding, where a debtor seeks only the opportunity to settle his debts, does not justify such an exception.

III. THE PUBLIC POLICY OF BOTH ERISA AND THE BANKRUPTCY CODE WILL BE BETTER SERVED BY EXCLUDING OR EXEMPTING PENSION BENEFITS FROM THE BANKRUPTCY ESTATE.

Petitioner argues that the policies behind the Bankruptcy Code override the policies of ERISA (Brief for Petitioner at 42), but does not explain why one federal statute should be preferred over another. In recent opinions such as *Guidry* and others discussed below, this Court has emphasized that two of ERISA's primary purposes are to protect retirement benefits and to ensure uniform regulation of pension plans. The interpretation of Bankruptcy Code § 541(c)(2) advocated by Petitioner would negate the uniform treatment of pension plans and subject them to the vagaries of state spendthrift law to determine when and where pension benefits would be included in a bankruptcy estate. By contrast, the position taken by Respondent and by the Court of Appeals for the Fourth Circuit in its opinion below would reaffirm a single, national standard and protect retirement income when such protection is needed most.

A. ERISA's Most Important Purpose Is to Safeguard Retirement Income.

When adopting ERISA, Congress stated that the statute's

> most important purpose will be to assure American workers that they may look forward, with anticipation, to retirement with financial security and dignity, and without fear that this period of life will be lacking in the necessities to sustain them as human beings within our society.

H.R. Rep. No. 93-533, 93rd Cong., 1st Sess., at 8 (1973), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4639, 4646.

The anti-alienation provisions of ERISA and the IRC were intended not only to prevent an employee from improvidently bargaining away his retirement benefits through voluntary assignment or alienation but also to protect his pension benefits against claims of general creditors; they were to "further insure that employee's accrued benefits are actually available for retirement purposes . . . . " H.R. Rep. No. 93-807, 93rd Cong., 2d Sess., at 68 (1974), *reprinted in* 1974 U.S. CODE CONG. & ADMIN. NEWS 4670, 4734.

In *Guidry*, this Court recognized and emphasized this congressional purpose:

> [ERISA §] 206(d) reflects a considered congressional policy choice, a decision to safeguard a stream of income for pensioners (and their dependents, who may be, and perhaps usually are, blameless), even if that decision prevents others from securing relief for the wrongs done them. If exceptions to this policy are to be made, it is for Congress to undertake that task.

493 U.S. at 376.[9] Relying on *Guidry* in its opinion below, the Fourth Circuit recognized the strong public policy of ERISA to protect retirement benefits from creditors. *Shumate*, 943 F.2d at 365. It is impossible to reconcile this policy with Petitioner's view – and that expressed in *Goff* and *Graham* – that pension benefits are to be included in the bankruptcy estate and subject to distribution among creditors. Congress made no exceptions to ERISA's anti-alienation language when adopting the Bankruptcy Code; the congressional policy to safeguard retirement income is perhaps most needed during insolvency proceedings.

B. Congress Intended a Uniform Federal Law to Apply to Pension Plans.

ERISA was intended to establish a uniform federal law to govern all pension plans. To accomplish this result, Congress included a broad preemption of state law in ERISA § 514(a). 29 U.S.C. § 1144(a). When introducing the Conference Report on ERISA, Senator Harrison Williams, Chairman of the Senate Committee on Labor and Public Welfare, stated:

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[9] In fact, Congress did create an exception to the anti-alienation provisions of ERISA and the IRC as originally adopted to permit assignment or alienation of an employee's pension benefits for alimony, child support or division of marital property rights. ERISA § 206(d)(3) and IRC §§ 401(a)(13)(B) and 414(p), added by the Retirement Equity Act of 1984, Pub. L. No. 98-397, 98 Stat. 1483.

> It should be stressed that with the narrow exceptions specified in the bill, the substantive and enforcement provisions of the conference substitute are intended to preempt the field for Federal regulations, thus eliminating threat of conflicting or inconsistent State and local regulation of employee benefit plans.

120 Cong. Rec. S29933 (1974), *reprinted in* 1974 U.S. Code Cong. & Admin. News, 5177, 5188. Similarly, Representative John Dent, Chairman of the Subcommittee on Labor of the House Committee on Education and Labor, stated:

> I wish to make note of what is to many the crowning achievement of this legislation, the reservation to Federal authority of the sole power to regulate the field of employee benefit plans. With the preemption of the field, we round out the protection afforded participants by eliminating the threat of conflicting and inconsistent state and local regulation.

120 Cong. Rec. H29197 (1974), *quoted in In re Messing*, 114 Bankr. at 548.

This Court has recently confirmed the importance of the uniform regulation of employee benefit plans intended by ERISA:

> To require plan providers to design their programs in an environment of differing State regulations would complicate the administration of nationwide plans, producing inefficiencies that employers might offset with decreased benefits. See Fort Halifax Packing Co. v. Coyne, 482 U.S. 1, 10 (1987). Thus, where a "patchwork scheme of regulation would introduce considerable inefficiencies in benefit program operation," we have applied the preemption clause to ensure that benefit plans will be governed by only a single set of regulations. Id., at 11.

FMC Corp. v. Holliday, ___ U.S. ___, 111 S.Ct. 403, 408 (1990) (citing *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 523 (1981)).

In another recent opinion, the Court again recognized the breadth of ERISA's preemption clause and reaffirmed that Congress had intended to create a national law surrounding employee benefit plans and to avoid differences in treatment of such plans on a state-by-state basis:

> Allowing state based actions like the one at issue here would subject plans and plan sponsors to burdens not unlike those that Congress sought to foreclose through § 514(a). Particularly disruptive is the potential for conflict in substantive law. It is foreseeable that state courts, exercising their common law powers, might develop different substantive standards applicable to the same employer conduct, requiring the tailoring of plans and employer conduct to the peculiarities of the law of each jurisdiction. Such an outcome is fundamentally at odds with the goal of uniformity the Congress sought to implement.

Ingersoll-Rand Co. v. McClendon, ___ U.S. ___, 111 S.Ct. 478, 484 (1990) (holding that ERISA preempted a state cause of action claiming a wrongful discharge to avoid the employee's attainment of pension benefits).

This congressional policy of national uniformity in the regulation of pension benefit plans has been implemented by the courts in all areas except the treatment of such benefits in bankruptcy. In this one area, the reliance

on state spendthrift trust law urged by Petitioner and required by *Goff, Graham* and similar cases has resulted in differing treatment for pension benefits based on factors such as:

- whether the pension plan in question is a defined contribution plan or a defined benefit plan;
- whether the participant is self-employed (or has an ownership interest in the business) or is a rank and file employee;
- whether the participant contributed to the plan or the employer made all contributions to the plan;
- whether the benefits are distributed (or available for distribution) immediately following termination of employment or whether access is restricted until a specified retirement age;
- whether benefits can be paid in a lump sum or only as an annuity or installments; and
- whether the plan permits in-service withdrawals and, if withdrawals are permitted, whether there is an absolute right to withdraw or whether withdrawals are subject to employer or administrative committee approval.

No policy considerations of the Bankruptcy Code justify the disparate results caused by differing state spendthrift trust laws. *Moore,* 907 F.2d at 1480. As the Fourth Circuit properly recognized in its opinion below,

> ERISA requires a plan to have a non-alienation provision, and that provision has been vigorously enforced. No more inquiry need be made to determine whether the trust is controlled by the settlor or the beneficiary, or whether they are the same person. . . .
>
> Hence, this court's holding in *Moore* precludes the fact-based state law inquiry urged by appellees.

Shumate, 943 F.2d at 364 (citations omitted). The congressional policy of a uniform of pension law throughout the nation can be accomplished only by recognizing that Section 541(c)(2) incorporates ERISA.

C. Courts Should Not Create an Incentive for Involuntary Bankruptcies.

Failure to exclude or exempt a debtor's interest in a pension plan from his bankruptcy estate will create a perverse incentive for his creditors to file an involuntary petition in bankruptcy. Prior to filing a petition in bankruptcy, a judgment creditor is clearly unable to garnish or otherwise levy upon a debtor's accrued benefits in a pension plan. However, if the anti-alienation provisions of ERISA do not exclude or exempt benefits from the bankruptcy estate, the same interest will be accessible by the same judgment creditor in a liquidation proceeding.

The Court in *Moore* recognized this anomaly and stated that failure to exclude benefits from the bankruptcy estate under the ERISA anti-alienation provisions "would provide creditors with a means to circumvent this

restriction on their access. We see no evidence that Congress intended to invite a creditor to push a debtor into involuntary bankruptcy in order to reach his ERISA funds." 907 F.2d at 1480.

IV. PENSION PLANS AND THEIR SPONSORS SHOULD NOT HAVE TO CHOOSE BETWEEN DISQUALIFICATION OF THE PLANS AND CONTEMPT CITATIONS.

The pension benefits which are the subject of this case were accrued by Respondent under the Coleman Furniture Corporation Pension Plan (the "CFC Plan"). The CFC Plan has been terminated and the benefits of all participants except Respondent have been distributed. Brief for Petitioner at 7-8. Because the CFC Plan has been terminated, its continuing qualification as tax-exempt is not an issue. However, whether distribution of benefits from a qualified pension plan to a trustee in bankruptcy will cause the plan to lose its tax-exempt status is a major concern for Hallmark and similarly situated plan sponsors.

The Department of the Treasury has been given primary responsibility for the administration and enforcement of ERISA provisions relating to minimum participation, vesting, and funding, including the anti-alienation provisions. ERISA § 3002, 29 U.S.C. § 1202, and Reorganization Plan No. 4 of 1978, *reprinted in* 6 Pens. Coord. (RIA) 84,011. The Internal Revenue Service has adopted the position that payment of a participant's accrued benefits to his bankruptcy trustee will violate ERISA's prohibition against assignment or alienation and

will result in the disqualification of the plan as tax-exempt. The IRS has stated this view in several private letter rulings, *see, e.g.*, PLRs 8131020, 8829009, 8910035, 8951067, 9011037,[10] and has filed *amicus* briefs on this issue. *See, e.g.*, *McLean v. Central States, Southeast and Southwest Areas Pension Fund*, 762 F.2d 1204, 1208 (4th Cir. 1985).

The Court in *Moore* recognized the validity of the IRS position:

> [O]ur holding avoids the specter of a bankruptcy trustee disqualifying an entire plan from tax exempt status by seeking turnover of a single bankrupt's interest in the plan. . . . If § 541(c)(2) does not recognize ERISA as "applicable nonbankruptcy law" that operates to exclude pension interests from the bankrupt's estate, then the plan's anti-alienation provisions will be violated and the plan may be subject to disqualification and loss of tax-exempt status. . . . We do not think Congress intended such a result. We can best harmonize ERISA, the Bankruptcy Code, and the Internal Revenue Code by reading "applicable nonbankruptcy law," 11 U.S.C. § 541(c)(2), to include ERISA.

907 F.2d at 1480-81.

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[10] Pursuant to IRC § 6110(j)(3), a private letter ruling may not be relied upon or cited as precedent by any taxpayer other than the taxpayer to whom it is addressed. However, such rulings generally provide a good indication of the IRS's position on a particular issue, especially when, as here, the Service has issued several rulings on the same issue with the same conclusion.

Loss of a pension plan's tax-exempt status would have serious, far-reaching consequences. Disqualification would result in taxation of the investment income to the pension trust. Plan participants would recognize as taxable income in the year of disqualification all amounts in their individual accounts without any corresponding distributions to enable them to satisfy the tax liability (unless the plan is terminated and the benefits distributed). Furthermore, if distributions are made from a nonqualified plan, the benefits would not qualify for rollover to individual retirement accounts nor for favorable tax treatment such as five- or ten-year income averaging. Failure to operate a plan in accordance with the governing documents is also a breach of fiduciary duty by a plan sponsor or administrator who could be liable to make good to the plan and its participants any losses resulting from the breach – such as the tax costs. ERISA §§ 404(a)(1)(D) and 409, 29 U.S.C. §§ 1104(a)(1)(D) and 1109.

Concerned over the possible loss of its tax-exempt status, the Central States Pension Fund in *McLean* refused to pay benefits due to a debtor directly to his bankruptcy trustee and was actually held in contempt by the district court for its refusal. The Fourth Circuit reversed both the pay order and the contempt order based on a conclusion that the pension fund qualified as a spendthrift trust under Illinois law. 762 F.2d at 1206-07. Although the Fourth Circuit has now properly repudiated the spendthrift trust analysis used in *McLean*, the case demonstrates the very real dilemma that has been created by the confused state of the law. Hallmark and other plan sponsors should not be "poised between the Scylla of tax

disqualification and the Charybdis of bankruptcy court contempt, they seek only a safe passage through this statutory strait." *Regan v. Ross*, 691 F.2d at 87.

CONCLUSION

The plain and unambiguous meaning of the statutory language in ERISA and the Bankruptcy Code compels the conclusion that a debtor's pension plan interests are excluded from his bankruptcy estate by Section 541(c)(2) or exempted under Section 522(b)(2)(A). This conclusion is in accord with the dual policies underlying ERISA to safeguard pension benefits and to establish uniform national regulation of pension plans. Therefore, Hallmark urges the Court to affirm the Fourth Circuit's decision below. At the very least, however, the Court should assure plan sponsors and solvent participants that their pension plans will not be disqualified if they are forced to comply with a turnover order.

Respectfully submitted,

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